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POSSIBLE FUTURE WORK

Legal Aspects of Receivables Financing

Report of the Secretary-General

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INTRODUCTION

1. The Commission at its twenty-sixth session in 1993 considered a note by the Secretariat containing a brief discussion of certain legal problems in the area of assignment of claims and of past and current work on assignment and related topics. [1] After considering that note, the Commission requested the Secretariat to prepare, in cooperation with UNIDROIT and other international organizations, a study on the feasibility of unification work in the field of assignment of claims, so as to permit the Commission to decide at its twenty-seventh session whether it should undertake work in this area of law. [2] The present report has been prepared pursuant to that request. The report focuses on assignment of receivables as the legal technique used in the context of receivables financing.

2. With a view to determining the feasibility of any future work on receivables financing, the first part of the report discusses the possible scope of such work, and for the purposes of the discussion defines the concepts used in the report; in the second part, some problems arising in assignment of receivables are discussed along with possible solutions that could be adopted in any future uniform rules, whether in a convention or in a model law. In implementing its mandate to prepare this report in cooperation with UNIDROIT and other international organizations, the Secretariat made a preliminary draft of the report available to UNIDROIT, the Hague Conference on Private International Law and the European Bank for Reconstruction and Development (EBRD) for their comments. In addition, the Secretariat will orally introduce this report to the Governing Council of UNIDROIT at its upcoming meeting (Rome, 9 to 14 May 1994).

I. SCOPE OF WORK

A. Assignment of receivables

3. "Receivables financing" is a term used in practice to describe a wide range of transactions in which finance is raised on the basis of receivables. Receivables financing may be linked to complex transactions, such as joint ventures, other contractual arrangements or the issuance of securities. [3] In an assignment of receivables, a party ("assignor") transfers to another party ("assignee") payment claims that the assignor has against a third party ("debtor") under a separate transaction for goods sold or leased, facilities made available or services rendered ("the original transaction"). The assignment is given in fulfilment of a sales or credit transaction in which the assignor is the debtor and the assignee is the creditor ("the underlying transaction"). The term "receivables", although there does not seem to be a generally accepted definition, is widely used as a generic description of payment claims. Receivables financing may involve assignments by way of sale or by way of security (see paragraphs 6-9), non-notification assignments (see paragraph 10), factoring (see paragraphs 11-12), forfaiting (see paragraph 13), or even more sophisticated techniques such as particular forms of securitization and project finance (see paragraphs 14-16).

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[1] A/CN.9/378/Add.3.

[2] Report of the United Nations Commission on International Trade Law on the work of its twenty-sixth session (1993), Official Records of the General Assembly, Forty-eighth Session, Supplement No. 17 (A/48/17), para. 301.

[3] Fidelis Oditah, Legal aspects of receivables financing (Sweet & Maxwell 1991), p. 19.

4. It would appear that some unification work in the field of receivables financing might be considered both desirable and feasible. The differences existing between legal systems on assignment of receivables, and the fact that States generally require compliance with their own requirements and formalities for an assignment to be valid and effective towards the debtor and third parties, may result in one and the same assignment being valid in the State where it was concluded but unenforceable against the debtor in another State. In addition, the uncertainty of law resulting from the lack of adequate modern rules on assignment of receivables may render assignment impractical in a cross-border context. As a result parties may often be forced to forego receivables financing in international trade and to revert to other, potentially more expensive means of financing, such as overdraft facilities, letters of credit or export guarantees, or to secure receivables through bank guarantees or letters of credit, or to accept that receivables are assigned at a value substantially less than their face value, due to the high risk that the assignee may not be able to collect part or all of their value.

5. Recent unification work in a part of this area of law may be seen as an indication that unification in the area of receivables financing may be considered feasible. The UNIDROIT Conventions on International Factoring and on International Financial Leasing (Ottawa, 1988) have been ratified by two States and require one more ratification or accession in order to enter into force. In addition, a number of countries in which the EBRD operates are about to enact or consider enacting legislation based on the Model Law on Secured Transactions prepared by the EBRD.

B. Assignment by way of sale and by way of security

6. Receivables may either be sold or used as security, or, stated in commercial terms, they may be assigned in order to generate income (when they are sold) or to facilitate access to credit (when they are used as security). Assignment of receivables by way of sale may be defined as the transaction whereby the assignee acquires full property rights on the assigned receivables, advancing all or part of their value to the assignor. Assignment by way of sale may be with or without recourse, that is, it may or may not provide for the assignor to guarantee the assignee against default by the debtors. Such assignment is also known in practice as "invoice discounting" or "block discounting" (see paragraph 8). In certain circumstances, it is also referred to as "factoring" (see paragraphs 9-10). Assignment of receivables by way of security is the transaction whereby the assignee acquires limited property rights in the assigned receivables, in the sense that the assignee is entitled to collect them only in the event that the assignor defaults in the performance of its obligations towards the assignee under the underlying credit transaction. It may be noted that, in some jurisdictions, the assignee in an assignment by way of security acquires title to the receivables, and it is only the underlying transaction that may limit its powers if it is a credit transaction. While to a large extent the same issues arise in both kinds of assignment, there are some differences. For example, in case of default of the assignor in the performance of the underlying transaction, if an assignment by way of sale is involved, the assignee can retain any surplus from the assigned receivables that it collects, while in assignment by way of security any surplus is to be returned to the assignor. In addition, in case of assignment by way of security, if the assignee collects the assigned receivables from the debtor without the assignor having defaulted in the performance of the underlying transaction, it may be liable to the assignor for breach of contract.

7. There are several possible approaches as to the manner in which assignment of receivables could be addressed in the context of uniform rules. One possibility, based on an approach followed in some jurisdictions, would be to address assignment in general terms, and to leave specific issues of assignment by way of sale to the national law on sales, and specific issues of

assignment by way of security to the national law on credit transactions. The main disadvantage of such an approach would be that, to a large extent, it would fail to produce uniform results. Another approach, followed in other jurisdictions, would be to cover assignment as a predominantly sales transaction. While such an approach would not preclude States from applying the uniform rules to assignment by way of security as well, it would fail to regulate an important part of receivables financing that could benefit from any uniform rules. In addition, it would fail to recognize the fact that, to a large extent, the issues raised in assignment by way of sale and by way of security are identical. Moreover, it would have the disadvantage of resulting in a duality of regimes. Yet another approach, followed in other jurisdictions and recommended here, would be to address both kinds of assignment in a single set of rules. Such an approach would have the advantage of recognizing the financing purpose of both kinds of assignment. Sales of receivables that are not for financing purposes, e.g., sales for collection only, sales in which the assignee is to perform the obligations of the assignor under the original transaction, sales of single receivables in payment of preexisting debts and sales as part of a sale of a business, would presumably have to be excluded. While most issues could be addressed by common rules applicable to both kinds of assignment, other issues would have to be dealt with differently, e.g., the issue of default of the assignor.

8. In some jurisdictions, assignment by way of security is referred to as a secured transaction, namely, a transaction creating a security right in receivables in the sense of a limited property right of the assignee to collect the receivables in case the assignor defaults in the performance of the underlying transaction. In those jurisdictions, even assignments by way of sale are viewed as secured transactions, provided that they are made for financing purposes. At the same time, in such jurisdictions, secured transactions are regulated in a comprehensive way in the sense that a single set of rules governs secured transactions in personal property, including goods, mobile equipment, inventory, receivables and general intangibles. It may be noted that such a comprehensive approach will be considered by the UNIDROIT Secretariat which has been authorized by the Governing Council at its 72nd session in June 1993 to prepare a study on the feasibility and desirability of drawing up a model law on secured transactions. [4] In the preparation of that study and the eventual elaboration of any draft rules close cooperation between the Commission and UNIDROIT seems desirable (see also below, para. 55).

9. If the UNIDROIT study were to establish the feasibility of such a comprehensive approach, the relationship between such work and the suggested project on receivables financing would have to be decided upon in concrete terms, in particular whether any draft statutory provisions on receivables financing should eventually be incorporated into a considerably more comprehensive model law; at least, there should be means to prevent substantive inconsistencies between texts on transactions with common characteristics. It may be added that UNIDROIT itself would face the same situation in a more acute manner, in view of the fact that it currently follows also the sectoral approach by preparing a draft convention on certain aspects of security interests in mobile equipment, based on the understanding that a narrowly defined scope of work is an indispensable condition of the feasibility of such work. [5]

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[4] UNIDROIT 1994, C.D. (73)8.

[5] UNIDROIT 1992, Study LXXII - Doc. 5, para. 6.

C. Non-notification assignment

10. "Non-notification assignment" refers to a type of assignment in which the debtor is not notified of the assignment. A major reason for using a non-notification assignment is that assignment may be viewed as indicating financial or managerial weakness of the assignor. The debtor may be notified only in exceptional circumstances, such as in the case of insolvency of the assignor, where the assignee may need to enforce the receivables against the debtor. Non-notification assignment is inherently more risky for the assignee, since the debtor can pay the assignor and be discharged. In addition, depending on whether priority among several assignees is based on notification of the debtor or registration of the assignment, a subsequent assignee notifying the debtor first or registering the assignment first will have priority. Examples of non-notification assignment include "block discounting" and "invoice discounting". "Block discounting" involves a non-notification sale of receivables in which the assignee retains, in addition to a security in the form of part of the face value of the receivables, a discount calculated by the average period during which it will be out of its money. The assignee usually undertakes to collect the receivables as an agent of the assignor and to guarantee payment by the debtors. "Invoice discounting" involves a non-notification sale of receivables in which the assignor continues to be responsible for collections as agent of the assignee, the undisclosed principal. [6]

D. Factoring

11. Factoring is often understood in practice as the sale of receivables for financing and other purposes. However, the UNIDROIT Convention on International Factoring ("the UNIDROIT Factoring Convention") covers both assignments by way of sale and by way of security. For the purposes of the Convention, factoring means "a contract concluded between one party (the supplier) and another party (the factor) pursuant to which: (a) the supplier may or will assign to the factor receivables arising from contracts of sale of goods made between the supplier and its customers (debtors) other than those for the sale of goods bought primarily for their personal, family or household use; (b) the factor is to perform at least two of the following functions: finance for the supplier, including loans and advance payments; maintenance of accounts (ledgering) relating to receivables; collection of receivables; protection against default in payment by the debtors; (c) notice of the assignment of the receivables is to be given to debtors." (art. 1). The Convention further specifies that "goods" includes services (art. 1(2)) and that the Convention applies when the receivables arise from international sales of goods (the supplier and the debtor have their places of business in different countries) and the factor is situated in a third country or when both the contract of the sale of goods and the factoring contract are governed by the law of a contracting State (art. 2).

12. Thus the Convention addresses a considerable number but not all kinds of factoring, and it leaves a number of issues arising in the area of factoring to the applicable national law (the title initially used for the Convention, i.e.,"draft Convention on Certain Aspects of International Factoring", clearly indicated that it was not intended to be comprehensive). In particular, the Convention does not cover factoring, if only financing, or just one additional service from the ones enumerated in article 1 of the Convention, is offered. The Convention does not cover assignment of domestic receivables or of receivables arising from leases or from transactions on the basis of which equipment or facilities are made available. Moreover, the Convention does not apply to non-notification assignment, such as block discounting or invoice discounting. At the same time,

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[6] Roy M. Goode, Commercial law (Penguin Books, 1982), p. 856.

the Convention does not cover certain issues arising in assignment of receivables, especially effects of assignment towards third parties.

E. Forfaiting

13. Forfaiting may be described as the sale of documentary receivables, that is receivables incorporated in negotiable instruments, such as bills of exchange, promissory notes, or in letters of credit and bank guarantees. However, the term "forfaiting" may be used to indicate the sale of non-documentary receivables that often may be backed by a bank guarantee or a letter of credit. Any unification work on forfaiting of documentary receivables might not be desirable in view of the fact that the assignment of such documentary receivables is already regulated by uniform statutory rules (e.g., the Geneva Uniform Laws on Bills of Exchange, Promissory Notes and Cheques), or uniform rules at the contractual level (e.g., assignment of proceeds of letters of credit under the ICC Uniform Customs and Practice for Documentary Credits and assignment of proceeds of bank guarantees subject to the ICC Uniform Rules on Demand Guarantees), or is the subject of other ongoing unification work (e.g., the UNCITRAL draft Convention on Independent Guarantees and Stand-by Letters of Credit). In addition, it should be noted that the issues arising in assignment of receivables would have to be addressed differently if documentary receivables were involved. For example, in the assignment of documentary receivables only defences based on the document incorporating the receivables could be raised by the debtor against the assignee, and priority among several assignees would have to be based on possession of the document in due course. However, future unification work could cover forfaiting of non-documentary receivables.

F. Securitization

14. Possible future work of unification could extent to a wide range of transactions described by the term "securitization", which may involve, assignment of receivables, not from a trader to a financing institution, but from one financing institution to another. Securitization may serve a number of different purposes and encompass a wide range of assets while there does not seem to be a uniform definition or practice of securitization, it may be described as the transformation of non-marketed assets, such as home mortgage loans, into marketable assets, such as securities. A basic, general structure of securitization that may involve the assignment of trade receivables from one financing institution to another for refinancing purposes may be described as follows: in a first step, the company or companies that created a discrete pool of financial assets ("the originator") may transfer them to another company, in return for capital stock or cash. In a second step, the initial transferee further transfers the assets to an investment fund, in return for cash and securities, i.e., equity or debt instruments of the type that the fund issues and sells to investors ("asset backed securities"). The initial transferee may take all the risk of loss on the assets and may have no recourse against the originator. Holders of securities issued by the ivestment fund may be entitled to a monthly distribution of interest at a stated rate.

15. Securitization is a relatively new financing technique growing internationally, which may serve a number of purposes, such as improvement of accounting status (e.g., replacement of non-cash assets on balance sheets by cash, improvement of return-on-assets and capital-to-assets calculations, which may improve the originator's standing towards its creditors), capital raising (higher credit rating for the securities than the originator itself possesses and lower financing costs) and regulatory compliance (e.g., compliance with lending limits and capital adequacy requirements).

G. Project finance

16. Work in the area of receivables financing could be relevant to project finance in which future revenues of an income-generating project are used to secure financing. Project finance may involve a sophisticated structure of a number of transactions, including assignment of receivables. It is a financing technique often used in projects related to the exploitation of natural resources, or projects related to the improvement of infrastructure, such as construction of power plants, bridges, highways and similar facilities. Project finance of this type appears to be increasingly of interest, in particular for developing countries and countries whose economies are in transition.

H. Commercial or consumer receivables

17. Future work could be restricted to commercial transactions, or it could encompass consumer transactions as well. One reason for not covering consumer transactions is that consumer law usually involves social policy matters that States tend to wish to decide for themselves, and is, therefore, not easily unified. Another reason might be that, at least at the present time, the volume of consumer transactions taking place at an international level might be too small to justify their consideration in an international context. It might, therefore, be preferable to limit the scope of any future work to commercial receivables only. On the other hand, the notion of "commercial" or "trade" receivables might raise some difficulties since, in some jurisdictions, no discrete body of commercial law exists. In other jurisdictions, the notion of "commercial" is defined on the basis of the nature of the transaction, or on the basis of the capacity of the parties as "merchants". It may be noted that the UNIDROIT Factoring Convention, like the United Nations Sales Convention, focuses on commercial transactions by excluding those transactions that are not "for personal, family or household" purposes.

I. International or domestic receivables

18. Another question of relevance to the scope of work is whether any possible future uniform law should apply to receivables arising only from international or also from domestic transactions. The criterion utilized in modern conventions, such as the United Nations Sales Convention and the UNIDROIT Factoring Convention, as the sole criterion for determining the internationality of a transaction is the place of business of the parties involved. Such an approach is deemed to be preferable from the standpoint of simplicity and maximization of the scope of work. [7] In favour of addressing both international and domestic receivables, it could be maintained that the same need for legal certainty exists both in domestic and international trade. Moreover, a duality of regimes, a national one for domestic receivables and a uniform one for international receivables, might create obstacles to trade by adding to the existing diversity of applicable legal regimes. On the other hand, limiting the scope of any possible future work to international receivables would be in line with the purpose of facilitating international trade. Moreover, States might be reluctant to accept alterations of their national laws on assignment purely in a domestic context. In addition, a set of rules applicable only to international transactions might have a unifying effect even with regard to domestic transactions, since it would be open to individual States to apply these rules to domestic transactions as well. It might, therefore, be more appropriate to limit the scope of work to international receivables only.

19. However, a further limitation of the scope of future work to international assignments of international receivables only (i.e., when the assignor and the debtor have their places of business in different countries) would be unwarranted. Such a limitation could result in excluding the bulk

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[7] Roy M. Goode, Reflections on the harmonization of law, Uniform Law Review, 1991, I, p. 64.

of the assignments since assignments are usually domestic. In addition, the crucial problem of the possible unenforceability of international receivables arises irrespective of whether the assignment is domestic or international. Moreover, if future work were limited to international assignments only, there would be two legal regimes governing assignment, one applying to domestic assignments and another applying to international assignments. It may be noted that the UNIDROIT Factoring Convention applies to both domestic and international factoring of international receivables .

II. POSSIBLE ISSUES

A. Assignability of receivables

20. Generally speaking, all receivables are assignable, unless their assignment is prohibited by agreement, by statute, or due to public policy considerations. Statutory prohibitions of assignment of receivables, such as prohibitions against assignment of wages, will not be considered in this report; it would not be feasible or appropriate to attempt to prepare uniform rules covering all kinds of statutory prohibitions. However, prohibitions by agreement and prohibitions due to public policy will be touched upon below, in view of their practical importance (see paragraphs 21-25).

1. No-assignment clauses

21. Parties often include in their contracts a clause precluding the creditor from assigning the rights arising therefrom. Legal systems differ as to the extent to which such clauses are upheld. Assignments concluded in violation of such clauses are in some jurisdictions valid in general, in other jurisdictions valid only as between the original creditor/assignor and the assignee, and generally invalid in yet other jurisdictions.

22. One approach that might be considered for a uniform text would be to treat an assignment concluded in violation of a no-assignment clause as valid only if certain requirements are met. Such an approach might have the advantage of protecting the debtor from a number of adverse effects that might arise from a change in the identity of the creditor, including: the burden of having to keep track of one or more assignments; the risk that the debtor might overlook a notice of assignment and have to pay a second time; and the risk that the debtor might not be able to set up against the assignee all defences, regardless of whether they arose before or after the notice of assignment. One possible requirement would be that, within a certain time period, the debtor does not object to, or consents to, an assignment concluded in violation of a no-assignment clause. However, it might be difficult to establish a method to calculate the time period. Moreover, adopting such a requirement would enable the debtor to decide which of several conflicting assignees would have priority merely by consenting to one assignment and objecting to another. Such a result would not be in line with the purpose of the no-assignment clause, which is to protect the interests of the debtor, and not to determine priorities among adverse claimants. Another requirement might be that the initial creditor/assignor should specifically accept the no-assignment clause in writing. However, this might be impractical in receivables financing, since assignees would have to check carefully each original transaction, in order to ascertain whether the assignor had specifically accepted the no-assignment clause.

23. Another approach might be to provide, as does the UNIDROIT Factoring Convention, that the assignment is effective notwithstanding any agreement between the assignor and the debtor prohibiting such assignment. Such a rule would facilitate the practice of receivables financing, which would benefit from unrestricted transferability of receivables. Moreover, it might be considered that debtors do not need the additional protection that no-assignment clauses are intended to grant them, since debtors are widely permitted to avail themselves of defences,

including set-offs, against assignees. While keeping track of assignments and avoiding clerical and bookkeeping errors may entail some cost to the debtor, this could be viewed as a normal cost of doing business. It may be noted that, in order to accommodate the needs of States having a strong policy in favour of upholding no-assignment clauses, an exception to the above rule has been included in article 6 of the UNIDROIT Factoring Convention. This provision permits States to make a declaration to the effect that assignments contrary to no-assignment clauses shall have no effects towards the debtor, if, at the time of the conclusion of the original transaction, the debtor has its place of business in the State making the declaration.

2. Bulk assignments

24. Bulk assignments of future receivables are, in some jurisdictions, invalidated as being against public policy, in particular if the future receivables arise from contracts that do not exist at the time of assignment. In such jurisdictions, efforts are made by courts to remove obstacles to receivables financing by recognizing the validity of bulk assignments of future receivables provided that the future receivables are, at the time the receivables come into existence, "determined" or "determinable" as to their basic particulars (e.g., the amount and the identity of the debtor). [8]

25. One possible approach, adopted in article 5 of the UNIDROIT Factoring Convention, would be to provide that bulk assignments of all present and future claims are valid between the assignor and the assignee only, leaving the validity of assignment towards third parties to the applicable national law. Such a rule would have the disadvantage that one and the same bulk assignment may be valid as between the parties to the assignment and invalid towards the debtor and third parties. As a result, the debtor could claim that the assignment was invalid towards it, pay the assignor and thus be released. Similarly, if assignment is valid only between the assignor and the assignee, the creditors of the assignor could attach the receivables on the basis that the assignment was invalid towards them, with the result that the receivables would be effectively lost for the assignee. Another possible approach, widely adopted in national legal systems, would be to recognize in general the validity of bulk assignments of future receivables. Such an approach would facilitate receivables financing. The interests of the debtor would be protected, in as much as the debtor would not be obliged to pay the assignee until it would receive notice of the assignment (as to the interests of third parties, see paragraphs 36-42).

B. Form requirements

26. Legal systems differ widely as to the form required. In some jurisdictions, the assignment has to be in writing, while in other jurisdictions even a purely oral assignment suffices. As a result, one and the same assignment may be considered valid in one country and invalid in another. Another problem is that, even within a single jurisdiction, it may not be easy to ascertain the form requirement for a particular assignment, because there may be different requirements for different types of assignments (e.g., assignments by way of sale and assignments by way of security).

27. It appears that "writing", defined in a liberal fashion, would constitute an appropriate form requirement, since, even in the jurisdictions in which oral assignments are valid, parties tend to put assignment in writing. No other form might be necessary for the validity of the assignment between the parties thereto. In addition to writing, one might require notification of the debtor.

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[8] Hein Kötz, Rights of Third Parties. Third Party Beneficiaries and Assignment, International Encyclopedia of Comparative Law, Vol. VII, Ch. 13 (1992), para. 82.

However, imposing such a requirement might create obstacles to assignment, in particular to non-notification assignment, without providing any additional protection for the debtor, since in any case the debtor, in the absence of notification or knowledge of the assignment, could refuse to pay the assignee.

C. Effects of assignment between the assignor and the assignee

28. The effects of assignment between the assignor and the assignee, as between themselves, are usually governed by their contract of assignment and, as against the debtor, are subordinated to the provisions of the original transaction. In practice, parties to receivables financing tend to be very specific in their dealings as to their rights and obligations. Moreover, under the general principles of contract law, the assignor and the assignee must refrain from any action that could defeat or impair the purpose of the assignment. In the absence of a sufficiently detailed agreement, the matter would be dealt with by statutory rules. Such rules tend to address the extent to which the assignor warrants the existence and enforceability of the receivables and the solvency of the debtor. There appear to be few differences between legal systems on this matter. Generally speaking, an assignor who receives a price for the receivables is deemed to warrant their existence. Such a warranty would not exist if the assignee acquired the receivables without paying a price for them, unless the assignor explicitly undertook a warranty. In addition, the assignor usually does not warrant the solvency of the debtor, unless otherwise expressly agreed.

D. Effects of assignment towards the debtor

29. The primary goal of any rules on assignment may be to strike a balance between, on the one hand, the need to allow parties to mobilize receivables in order to obtain finance and, on the other hand, the need to ensure that the legal position of the debtor, who is not a party to the assignment, is not adversely affected by the change in the identity of the creditor. There are two main issues that arise in this context, namely, the conditions that have to be met for the assignment to produce effects towards the debtor, and the defences that the debtor may raise against the assignee.

30. While an assignment may be valid and binding on the assignor and the assignee, it has no effects on the debtor, unless an additional condition is met. While the debtor's obligation to pay to the assignee depends on the debtor acquiring knowledge of the assignment, legal systems differ as to whether a notice to the debtor is required or whether any other act results in the debtor acquiring knowledge of the assignment. Moreover, legal systems requiring notice differ on the effects of knowledge of the assignment on the part of the debtor in case no notice is given.

31. The requirement of a complete written notice would protect the debtor from ambiguities that might arise without such notice, for example, when the debtor has received some information about the assignment but has no information as to the identity of the assignee or the exact value of the assigned receivables. Matters related to written notice include: whether it would cover modern means of communications, such as fax or electronic data communications; the minimum content of the notice, e.g., reasonable identification of the assigned receivables and the assignee; which party can give notice, the assignor or the assignee, e.g., if the assignee is authorized by the assignor to give notice; whether notice is effective when dispatched, received or actually read by the debtor. Another question that would have to be addressed is the question whether the debtor, who has no formal notice of the assignment but knows of it, could pay the assignor and be discharged.

32. Legal systems differ as to which defences the debtor may raise against the assignee. An approach adopted in some jurisdictions is to allow the debtor to raise against the assignee defences

arising out of the same contract giving rise to the assigned receivables, no matter whether such defences arose before or after assignment or before or after notice thereof. Under an approach adopted in some other jurisdictions the debtor is permitted to raise defences arising from a separate contract between the debtor and the assignor, if those defences accrued before the debtor was notified about the assignment, irrespective of when the receivables become payable. An approach followed in yet other jurisdictions is to allow defences arising from a separate contract between the debtor and the assignor, provided that they involve claims that are due both at the time notification is given and at the time the assigned receivables become due. Yet another more liberal approach followed in some jurisdictions is to allow such defences irrespective of when notification took place or when the assigned receivables arise.

33. Legal systems differ on two other noteworthy issues related to defences of the debtor against the assignee demanding payment of the assigned receivables: the kind of proof the debtor is entitled to request, in case of doubt as to whether an assignment has been concluded; and whether the assignee has to return to the debtor any amount advanced, in case the assignor has not fulfilled its obligations towards the debtor under the original transaction. As to the first issue, a possible approach, adopted in some jurisdictions, is to provide that the debtor may request "reasonable" proof. A possible advantage of this approach is that the term "reasonable" is well known; even in jurisdictions in which that term has no technical legal meaning, it is commonly understood in practice. A possible disadvantage of this approach would be that use of the term "reasonable" would not achieve certainty and predictability, since its meaning would depend on the circumstances in which an assignment was concluded. A different approach would be to require written proof, so as to enhance certainty and predictability. As to the second issue, one approach, adopted in article 10 of the UNIDROIT Factoring Convention, is to provide that the assignee does not have to return any advances that the debtor might have made, unless unjust enrichment or bad faith on the part of the assignee was involved. Unjust enrichment could be involved if the assignee receives payment from the debtor but has not paid the assignor at the time the debtor demands the return of the advances made. The assignee might be in bad faith, if, for example, it pays the assignor for the assigned receivables despite knowing that the assignor has not performed its obligations to the debtor under the original transaction.

34. A number of other questions might arise, with respect to which unification might not be needed or feasible, including: whether the debtor can raise defences arising from separate transactions between the debtor and the assignee, or between the debtor and other assignors which might have assigned their receivables to the same assignee; whether, in case of subsequent assignments, the debtor can raise against the last assignee demanding payment any defences that it might have had against a previous assignee.

35. Defences of the debtor against the assignee create uncertainty as to whether the assignee will be able to collect. For that reason, in practice, waiver-of-defences clauses are often included in the contractual terms of the original transaction. In most jurisdictions, such waiver-of-defences clauses agreed upon at the time of the conclusion of the original transaction are generally upheld in commercial, but not necessarily in consumer, settings. [9] Some jurisdictions recognize waiver-of-defences clauses agreed upon between the debtor and the assignee after the debtor is notified of the assignment, as long as they involve defences that the debtor knew or ought to have known at the time of the waiver that they were available to him. In other jurisdictions, the debtor's acceptance of the assignment, orally or in writing, may be interpreted as a waiver of all or part of the

[9] Ibid., para. 99.

defences that the debtor might otherwise have against the assignee, provided that it is clear and beyond any doubt that the debtor accepting the assignment intended to waive its defences.

E. Effects of assignment towards third parties; priorities

36. As assignment is, in most jurisdictions, considered to be a contract between the assignor and the assignee, it produces effects between them. However, assignment is also a means of transferring property, and as such it may have effects towards third parties, such as several conflicting assignees, the assignor's creditors and the trustee in the bankruptcy of the assignor. Legal systems differ on whether the effects of assignment towards third parties arise from the assignment itself or from an additional act, such as notification of the debtor or registration of the assignment. A related issue is the order of priority among several creditors laying a claim on the same receivables. The issue of priority arises mainly if the assigned receivables are the main assets the assignor is left with, in particular in the case of insolvency of the assignor, since otherwise the assignor will be able to satisfy its creditors on the basis of other assets. A conflict of priorities may arise in the following situations: between several assignees, due to multiple assignments of the same receivables because of fraud or an unconscionable act of the assignor; between the assignee and the bankruptcy trustee, who may, for example, seek to invalidate the assignment on the ground that it constitutes a fraudulent transaction; between the assignee and the government as creditor of the assignor for taxes. As priority conflicts with the bankruptcy trustee and the government may involve general policy considerations of a social, economic and political character, they might best be left to the applicable national law or they might be addressed in the context of any possible future unification work on cross-border insolvency. This report will discuss only priority conflicts among several assignees or between the assignee and the assignor's creditors.

37. While the issue of third-party effects and the related issue of priorities is important in the context of some kinds of assignment, it may not be of such crucial importance in the context of other kinds of assignment, including: securitization, in which the risk of the insolvency of the assignor might be reduced by the fact that the assignor is usually a financing institution; forfaiting, in which receivables may be backed by a bank guarantee or a stand-by letter of credit and the assignee, in the case of insolvency of the assignor, might be paid out of the proceeds of the bank guarantee or the letter of credit; and project finance, in which the assignee might obtain a number of securities in addition to future proceeds from the project financed.

38. One approach, adopted in some jurisdictions, is to grant priority to the first assignee on the ground that once the assignor has assigned the receivables it does not own them any longer and therefore it cannot assign them a second time. Under such an approach, the assignor's creditors could not attach the receivables, since from the time of the assignment onwards, the receivables do no longer belong to the assignor. Another, similar approach, adopted recently in a jurisdiction in order to facilitate the assignment of trade receivables in the context of financing transactions, is to grant priority to the assignee that holds a document, signed by the assignor, listing the receivables, according to the date on that document (art. 4 of the so called loi Dailly). Such an approach has the advantage of simplicity and certainty, since in no instance could a subsequent assignee prevail. A difficulty with that approach, however, is that it provides no protection to subsequent assignees or to the assignor's creditors, who might have extended credit to the assignor relying on its receivables as security, and who have no way of knowing whether such receivables have already been assigned.

39. Another approach might be to grant priority to the first assignee to notify the debtor. In case of attachment of the assigned receivables by the assignor's creditors, the assignee would prevail, if

it had notified the debtor before attachment. One justification for such an approach could be that, since title to movables passes as a rule only if possession is granted to the transferee, title to receivables should pass only if notice to the debtor, which may be viewed as the nearest equivalent to taking possession, is given. That rule affords some protection to third parties, such as potential creditors of the assignor, since they are in a position to enquire whether the debtor has received a notice of a previous assignment before extending credit to the assignor. However, the application of such a rule might be impractical in receivables financing, where third parties might have to check with a large number of debtors receiving several notices. In addition, debtors could not be forced to provide information to debtors or be made liable for providing inaccurate or false information.

40. Yet another approach might be to grant priority to the first assignee to register the assignment in a public register. In case of attachment of the assigned receivables, the assignee would prevail, if the date of registration would be earlier than the date of attachment (for a discussion of registration, see paragraphs 43-51). Another approach based on a different type of registration would be to grant priority to the assignee that first had its assignment registered in the commercial books of the assignor. Such a system, however, has certain disadvantages. It might be seen as being unreliable, since it would be based on the assumption that the assignor would properly register all assignments. In case the assignor failed to update its books or made an error in registration or registered a subsequent assignment first, the first assignee would lose its priority and might have no remedy against the assignor if the assignor becomes insolvent. One possible way to alleviate the difficulties arising with regard to this system would be to require the assignor to present its books to the assignee so that the assignee could verify the registration by the assignor or could itself register the assignment. However, the utility of such a system might be doubtful in view of the potential difficulty and the time and the cost involved in registering bulk assignments and obtaining access to registered information.

41. If a substantive-law solution to the problem of priorities could not be found, a private-international-law approach might be considered. One such private-international-law solution could be to provide that the effects of assignment toward third parties and the related issue of priorities would be governed by the law of the State where the assignor had its place of business. This approach presents certain advantages. It provides a single point of reference for the bulk assignment in the context of receivables financing, even though the debtors may be resident in several countries. In addition, the law of the assignor's place of business is ascertainable at the time of the assignment even where the debts have not yet come into existence. Moreover, the choice of this law appears to be appropriate in case there is a requirement for registration of the assignment, since potential assignees are likely to look to the assignor's place of business to see whether it has already assigned its receivables. One possible difficulty with such an approach is that it might not be easy to identify the place of business of the assignor, for example, in case a company was registered in one particular place but operated in other places. Another possible difficulty might be that the priority issue could be characterized as an issue of contract, tort, property, bankruptcy or procedural law, which would complicate the elaboration of a generally acceptable private international law rule.

42. Another possible approach would be to devise a rule combining substantive and private international law elements and providing that the first assignee in time, the first assignee to notify the debtor, or the first assignee to register the assignment in a public register would have priority, depending on the approach followed in the law of the State in which the assignor had its place of business. Such an approach would have the disadvantage of failing to produce uniform results. However, it would, to some degree, enhance certainty and could be acceptable in that it would not alter existing approaches to the issue of priorities.

F. Registration

43. Registration of an assignment could be described as the process of filing information about the assignment at a register administered by a public authority for the purpose of providing evidence of title to the receivables, notice about the assignment to interested third parties, or a method for determining priorities. Registration of assignments or other similar transactions is already practiced in some jurisdictions. In some other jurisdictions, registration is currently under consideration by law reform commissions entrusted with the task of modernizing the law on secured transactions, or is suggested as a plausible solution to the problem of priorities. [10] In jurisdictions in which registration of assignments or similar transactions is not practiced, the general concept of registration is not necessarily new, since other types of transactions or rights are already subject to registration, for example, secured transactions with regard to immovables and transactions involving rights related to ships, aircraft, patents, trademarks and copyrights. It should be noted that registration is also practiced in an international context. For example, the World Intellectual Property Organization (WIPO) serves as a registering authority with regard to trademarks and designs. WIPO functions also as an international centralized data bank with regard to patents, which allows international users to obtain access to information registered at national registers. The utility of registration at an international level has also been recognized within the Study Group of UNIDROIT entrusted with the task of preparing uniform rules on certain international aspects of security interests in mobile equipment. [11]

44. Beyond assignment of receivables, registration is an important issue arising in the context of other possible future work topics of UNCITRAL. Registration and transfer of rights at an international level is an important issue in the context of the negotiability of rights in goods. The Working Group on Electronic Data Interchange adopted at its twenty-seventh session (New York, 28 February-11 March 1994) a recommendation to the Commission that it should authorize the Working Group to undertake preliminary work on negotiability of rights in goods as soon as it has completed the preparation of the model statutory provisions on the legal aspects of electronic data interchange and related means of data communications. [12] It may also be noted that registration of dematerialized or uncertificated securities, i.e., securities that do not have a tangible form, is an important issue that will be touched upon in a preliminary note on future work which the Secretariat intends to submit to the Commission at a future session. Many of the legal issues arising with regard to registration in those different areas might be identical, irrespective of whether the rights transferred are in goods, receivables, or securities, while other legal issues might be different depending on whether registration of rights in goods, receivables or securities is involved.

45. It appears that a solution based on registration would protect the interests of third parties and provide an objective criterion on the basis of which conflicts of priority could be resolved. Moreover, the cost and time involved in registration might not be prohibitive since registration could be based on a computerized register accessible through modern communication systems. As

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[10] John Dulley, A National Register of Personal Property Securities (Australian Law Reform Commission, Personal Property Securities Research Paper 1); Lane H. Blumenfeld, A hole in the bucket. The unavailability of financial credit due to the lack of a registry in Russian collateral law, Law in Transition (Winter/Spring 1994), p. 14.

[11] See UNIDROIT 1993, Study LXXII - Doc. 7 para. 11.

[12] A/CN.9/390, paras. 154-158.

to the issue of privacy of the assignor, which might be of importance for its image in the market, it should be noted that there could be ways to ensure that access to registered information would be available only under certain conditions and only to parties towards whom registration could produce effects (see para. 48). In this context, it should also be noted that financial data of companies, such as assets, encumbrances on assets, loans payments, defaults in payments, dishonored checks, are, in many jurisdictions, already collected by central or commercial banks or other institutions and made available to financing institutions through a national or international telecommunications system. With regard to the concern that even a restricted publicity requirement might unduly interfere with the privacy of the assignor, it may be noted that the possible negative impact of a registration system on the privacy of the assignor would have to be weighed against the potential benefit of the increased chances for obtaining credit on the basis of receivables in an amount closer to their face value.

46. Registration could take place in an international register or in a central national register accessible through an international centralized data bank. An international register would facilitate both registration and access to registered information. Moreover, the legal framework for such an international register would require a set of uniform rules that in all likelihood would need to be in the form of a convention. As to the concerns related to cost of establishment and operation of an international register, simplicity and ease of registration and access to information registered in an international register, a way to alleviate those concerns, at least in part, might be to establish an international registration system with a United Nations agency as registering authority, which would make use of existing means and would be accessible throughout the world due to the universal nature of the United Nations. In case the establishment of an international register proves to be not feasible, a central international data bank might be established so that the information filed at national registers could be made available to international users through modern means of communications. Such a registration system would not necessarily make registration easier for international creditors but it could facilitate their access to the registered information. Central national registration accessible through an international centralized data bank could have the advantage that its implementation might be easier and less costly, since it could benefit from existing national registers and data bases, which, with some modifications, could be integrated into a new registration system. However, such a registration system would to some extent fail to produce uniform results; registration and its effects on third parties would be subject to national law, while issues related to access to registered information could be addressed either in a convention or in a model law. Whether an international register or an international centralized data bank is preferred, the example of WIPO serving as an international registering authority with regard to trademarks and designs and as an international centralized data bank with regard to patents could serve as a precedent (see paragraph 43).

47. Registration raises a number of legal issues, such as its legal effects, authentication of the document to be filed, liability of the registering authority for failing to follow authentication procedures or for errors in the record to be issued by the registering authority upon demand by interested parties, evidential weight of that record, and registration of a statement of release of the assignor in case of assignment by way of security.

48. Registration could be deemed to have a number of legal effects, including: evidence of title or other rights in receivables; notice to third parties about the assignment; and determination of priority among several adverse claimants. One issue that would have to be considered would be whether notice could produce effects against all third parties or against only some categories of third parties, e.g., third parties that could reasonably be expected to search in a register. Financing institutions, for example, that provide credit on the basis of receivables in the ordinary course of their business could reasonably be expected to search in a register. However, for

medium-size or small suppliers of materials on credit, who retain the title on the materials until they are fully paid and obtain rights in the receivables arising from the resale of the end-product as assignees, it might be impracticable to search in registers. Another issue that would arise in case registration were to function as a system to settle priorities would be whether the first assignee to register would be deemed to have priority over assignees that failed to register or registered subsequently, and over creditors of the assignor that attempted to attach the assigned receivables after registration. Were such a rule to be adopted, some exceptions would need to be made.

49. The document to be filed, i.e., the contract of assignment in its entirety or a summary statement thereof, would need to be authenticated. Authentication would be necessary in order to confirm, in particular, whether the assignor and the assignee mentioned in the document filed are the actual parties to the assignment and approve the contents of the document filed. One issue arising in respect to authentication is the authentication procedure that the registering authority would have to follow, e.g., an agreed authentication method, or in the absence of agreement, a reasonable or any authentication method. Another related issue is the liability of the registering authority for failing to follow any authentication method with the result that inaccurate or false information is filed and damage is caused to the parties involved. Yet another issue is the liability of parties entitled to register for filing inaccurate or false information. Provision might have to be made to the effect that the assignee filing an inaccurate or false notice could not benefit from it, and that such an assignee should be liable in damages to the assignor, in case the latter suffers loss as a result of the misconduct. The allocation of responsibility for inaccurate or false filings would presumably have to be different if registration were a joint act of the assignor and the assignee.

50. Upon demand by parties entitled to obtain access to information filed, the registering authority would have to issue a record reflecting the information filed. Such a record might be needed by the assignor or its potential creditors seeking to establish the "creditworthiness" of the assignor on the basis of its receivables. An important issue is the evidential weight of such a record, in particular if it is in the form of a fax or an electronic communication. A related question is the possible liability of the registering authority for errors in such a record, resulting in disparities between the information in the register and the information reflected on the record issued. The responsibility of the registering authority might be limited to direct damages caused by gross negligence and wilful conduct or be expanded to include profits lost as a result of errors in the record issued due to negligence. In this context, provision might have to be made for a mechanism for the payment of claims based on errors of the registering authority. For example, part of the registration fees or other income of the registering authority could be deposited in a fund, and claims against the registering authority could be paid out of the fund.

51. In case of an assignment by way of security in which the assignor fulfilled its obligations under the underlying credit transaction or provided other security, a statement of release of the assignor would have to be filed, whereby the interest of the assignee in the receivables would be waived. Such a statement could be filed by the assignee on its own initiative or upon written demand by the assignor. In case the assignee fails to file such a statement of release in a timely fashion, the assignor may not be able to utilize its receivables for obtaining further credit. In this regard, the issue of the remedies of the assignor arises. One possible remedy is to establish a right of the assignor to request and obtain upon presentation of certain documents a statement of release from the registering authority. Such an approach might be disadvantageous in that it would place an undue burden on the registering authority to check the substance of the documents submitted. Moreover, it could expose the registering authority to liability for errors in the evaluation of the documents. Another possible remedy is to give to the assignor the right to obtain interim relief in the form of an order to the registering authority to issue, or to the assignee to file, a statement of release.

CONCLUSION

52. On the basis of the above discussion, it may be concluded that the disparity of laws on assignment adversely affects the availability and functioning of receivables financing on the international plane. It may further be concluded that the situation could be improved by the preparation of a uniform legal text that would take into account the UNIDROIT Factoring Convention but would go far beyond it, especially as regards its scope of application.

53. As discussed in paragraphs 11 to 16, the scope could be extended to include not only those factoring situations not covered by the UNIDROIT Factoring Convention but also many other transactions encountered in such financial contexts as securitization, project finance and forfaiting of non-documentary receivables. A definite decision on whether assignments of receivables in each of these contexts should be covered requires, it is suggested, a further study which would discuss in respect of these various financial contexts the other questions of scope mentioned in part I (paragraphs 3-10, 17-19) and, in considerable detail and possibly accompanied by some first draft rules, the various substantive issues identified and discussed in part II.

54. Of all the substantive issues addressed in part II, the effects of assignments on third parties, with the related question of priorities, is probably the most complex and difficult one. As may be concluded from the discussion in paragraphs 36 to 51, the feasibility of tackling that issue in an appropriate, universally acceptable manner may be viewed as depending, at least in part, on the feasibility of establishing a reliable registration system. Since such a registration system might be useful also in areas other than receivables (e.g. documents of title, security interests, securities), it is suggested that a separate study be undertaken which would discuss in detail the relevant points, especially the legal aspects of the establishment and operation of a central international register.

55. Yet another conclusion that may be drawn from the discussion in this report is the desirability of the closest possible co-operation with UNIDROIT. Indeed, all possible means of co-operation, including hitherto untried ones, should be explored. For each stage of the preparatory work the most appropriate one should be selected, depending on UNIDROIT's attitude towards the suggested project and on its own work in related areas.

56. If the Commission were to share the above conclusions, it may wish to request the Secretariat to prepare the two studies mentioned in paragraphs 53 and 54. On the basis of those studies, it might wish to decide about the further course of action in this project, in particular whether at that stage a working group should be entrusted with the elaboration of a uniform legal text on receivables financing.

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CROSS-BORDER INSOLVENCY

Note by the Secretariat

Report on UNCITRAL - INSOL Colloquium on Cross-Border Insolvency

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INTRODUCTION

1. At the UNCITRAL Congress "Uniform Commercial Law in the 21st Century", held in conjunction with the twenty-fifth session (1992), it was proposed that the Commission should consider undertaking work on international aspects of bankruptcy. Consequent to that decision, the Secretariat presented to the Commission at its twenty-sixth session (1993) a note on cross-border insolvency, outlining various legal issues that might give rise to problems due to a lack of harmony among national laws (A/CN.9/378/Add.4). That note also provided a brief description of previous work at the international level towards harmonization of laws in the area. The prevailing view at the last session was that, despite concerns about the feasibility of a project to harmonize rules on international aspects of insolvency, the practical problems caused by the disharmony among national laws governing cross-border insolvencies warranted further study of legal issues in cross-border insolvencies and possible internationally acceptable solutions. The Secretariat was requested to prepare for a future session of the Commission an in-depth study on the desirability and feasibility of harmonized rules of cross-border insolvencies, a study that would consider which aspects of cross-border insolvency law lent themselves to harmonization and what might be the most suitable vehicle for harmonization (A/48/17, paras. 302-306).

2. As an initial step in gathering information for the feasibility assessment requested by the Commission, the Secretariat, with the co-sponsorship and organizational assistance of INSOL International, organized a Colloquium on Cross-Border Insolvency (Vienna, 17-19 April 1994). INSOL is an international association of practitioners from professions that participate in cross-border insolvency cases. The Colloquium was designed in particular to provide a forum for a dialogue among insolvency practitioners from various regions that have been exposed first-hand to the practice of cross-border insolvency, as well as being involved in efforts that have been made to date in the direction of harmonization of rules. As such, the Colloquium was geared to enabling the Commission to assess from a practical standpoint the desirability and feasibility of any future work that it might consider undertaking in this area. The approximately 90 participants from various countries included lawyers, chartered accountants, bankers, and judges that have presided over notable cross-border insolvency cases, as well as representatives of interested ministries of a number of Governments and of international organizations, such as INSOL and Committee J of the Section on Business Law of the International Bar Association (IBA). The main speakers included judges and practitioners that have had significant experience in cross-border insolvency cases, as well as individuals and representatives of organizations that have spearheaded international and regional harmonization efforts.

3. The present note presents an outline of the views and perspectives that were exchanged at the Colloquium, including a summary of possible directions and stages of work by the Commission that were indicated by the exchange of views and information that took place at the Colloquium.

DISCUSSION OF PREVAILING LEGAL ENVIRONMENT

A. General remarks

4. The view was widely shared at the Colloquium that the practical significance of legal aspects of cross-border insolvency would continue to grow, parallel to the ongoing expansion in multi-national economic activity. Emphasis was placed on the corresponding need to develop legal mechanisms for limiting the extent to which, in the event of insolvency in a cross-border context, disparities in and conflicts between national laws created unnecessary obstacles to the achievement of the basic

economic and social objectives of insolvency proceedings. Those objectives included, generally, protecting the rights and interests of creditors, employees, and debtors. In more specific terms, the legal rules applied in cases of cross-border insolvency should facilitate the rehabilitation of businesses that, in particular from an economic standpoint, merited preservation, thereby serving the goal of preservation of employment, and, in the event of liquidation, maximizing the value of the assets that were available to pay creditors' claims, without undue regard to the location of those assets.

5. It was widely reported that, in sharp contrast to the proliferation of multinational economic activity, the prevailing legal environment was generally not suitably geared to achieving the above-mentioned objectives in cases of cross-border insolvency. Many national insolvency laws claimed, for their own insolvency proceedings, application of the principle of "universality", according to which a unified administration of the insolvency would be the objective and court orders would be effective with respect to assets located abroad, while failing to accord recognition of universality to foreign insolvency proceedings. An example of difficulties that may arise in the context of a reorganization proceeding was the case in which one jurisdiction envisages a "debtor in possession" continuing to exercise management functions, while, under the law of another State in which a contemporaneous insolvency proceeding is being conducted with respect to the same debtor, existing management is displaced or the debtor's business is to be liquidated.

6. It was reported that, in such a prevailing legal environment, fragmentation and compartmentalization along national lines were prevalent in the administration of cross-border insolvencies. It was further reported that, in the face of gaps or inadequacies in the law, courts and practitioners attempting to harmonize administration of cross-border insolvencies might find that, at best, they had to attempt to rely on ad hoc protocols or agreements among the parties involved in administering the insolvency proceedings in order to provide for a harmonized administration of the insolvency estate in the cross-border context. Such procedures, which might be based on interpretations of general notions such as international comity, often would take place in an atmosphere of legal uncertainty that resulted from an inadequate legislative framework for cooperation.

7. While it was widely felt that it would not be feasible, at least in the foreseeable future, to solve those problems by way of a substantive unification of laws affecting cross-border insolvency proceedings, a variety of specific needs were identified that might be addressed by efforts short of unification of substantive law. Those specific needs included, in particular: systems to facilitate, in the context of liquidation proceedings, preservation of collateral and quick liquidation or, in the context of reorganization proceedings, mechanisms for facilitating rescue and rehabilitation of viable businesses by way of moratoria to prevent action by individual creditors; mechanisms at the legislative level to provide for the recognition of duly-appointed representatives and the recovery of assets, including by way of providing information to foreign insolvency proceedings; greater information and certainty for secured lenders as to the identity of the items in which they hold security; simplified systems for proving claims, in particular allowing creditors in appropriate circumstances to claim in their own countries and in their own language; recognition of foreign court orders; and recognition and enforceability of "net positions" of banks involved in multilateral netting arrangements.

B. Law reform efforts at the national level

8. Attention was drawn to law-reform efforts in a limited number of States that had taken place, or that were in progress, designed to foster a greater degree of universality in administration of cross-border insolvencies, as a basis for assistance other than the basis of comity or mere rules of private

international law. It was suggested that those efforts, which typically involved establishing mechanisms for granting court access to representatives of foreign insolvency proceedings and otherwise granting recognition to foreign proceedings, might serve as an indication of what might be feasible in terms of international harmonization.

9. Key features of such national law reforms intended to establish flexible frameworks for dealing with cross-border insolvencies included, for example: an opportunity for representatives of foreign insolvency proceedings to petition the bankruptcy court for ancillary proceedings, available at the discretion of the court or perhaps mandatory, to assist in the administration of the foreign insolvency proceeding; various forms of ancillary relief including injunctions blocking actions against the foreign debtor or property in the forum and turnover of property to the foreign representative for administration in the foreign proceeding; possible suspension or dismissal of a forum bankruptcy proceeding in deference to pending foreign insolvency proceedings; the opportunity for the foreign representative to petition for a full, involuntary insolvency proceeding as an alternative to a mere ancillary proceeding; appearances before forum courts by foreign representatives treated as "special appearances", thus not subjecting the foreign representative to the jurisdiction of the forum for any other purpose; criteria for assessing foreign proceedings for purposes of determining whether to recognize court exercise of discretion as to whether to grant recognition or ancillary relief (e.g., similarity on essential points between the legal system of the forum state and the foreign state; just treatment of all creditors; comity).

C. Initiatives at the international level

10. It was observed that, at the same time that specific provisions in national legislation designed to deal with cross-border insolvency remained the exception, there was also a lack of an extensive network of bilateral treaties that might provide relief, as well as a lack of a multilateral treaty arrangement on the global level. Multilateral treaties on a regional basis are, for example: in Latin America, the Montevideo Treaties of 1889 and 1940; in the Nordic region, the Convention between Denmark, Finland, Iceland, Norway and Sweden regarding Bankruptcy (concluded in 1933 and amended in 1977 and 1982); among the member States of the Council of Europe, the European Convention on Certain International Aspects of Bankruptcy (Istanbul, 1990); and, in the European Union, the draft Convention on Insolvency Proceedings.

11. Mention was also made of certain non-Governmental initiatives with a view to providing a legal framework or basis for harmonization of cross-border insolvency proceedings. One such initiative was the Model International Insolvency Co-operation Act ("MIICA"), formulated by Committee J of the Section on Business Law of IBA. The view was expressed that the experience of MIICA suggested the importance for the eventual success of harmonization efforts, in particular when those efforts took the form of model legislation, of involving Governments in the formulation process. It was noted that Committee J was currently engaged in a review and analysis of fundamental insolvency concepts with a view to developing a Model Insolvency Code, a set of uniform concepts that would be acceptable to or adaptable into domestic legislation. Another initiative to which attention was drawn was the research being conducted by the American Law Institute into a framework for cross-border insolvencies among the member countries of the North American Free Trade Agreement (NAFTA). (Additional information on multilateral initiatives towards regulation of cross-border insolvencies is presented in A/CN.9/378/Add.4.)

D. Cross-border judicial cooperation, ad hoc protocols and concordats

12. Particular attention was given in the discussion to the crucial function that is performed in cross-border insolvency by cooperation among the judges and counsel from the various States in which assets of the debtor might be found and in which insolvency proceedings are taking place. It was noted that the significance of such cooperation was enhanced, but that cooperation was made more difficult, by the absence of an adequate legislative framework for dealing with cross-border insolvencies and when there was a need to reconcile differences in the applicable national insolvency laws. Notable examples of judicial cooperation, and of cooperation among counsel and representatives of creditors and debtors, were described to the Colloquium by judges and counsel involved in a number of particularly significant cases of cross-border insolvency that have taken place in recent years. It was observed generally that an obstacle that hampered and made uncertain judicial cooperation was that judges seeking to establish cooperation typically had to do so without much guidance in the law.

13. Specific attention was also given in the discussion to the function that may be performed in a cross-border insolvency case by an ad hoc protocol agreed to by the various parties in interest and approved by the supervising judges. Such a protocol may be used, for example, to establish the system of corporate governance that will be applied to the debtor in a reorganization proceeding. A protocol dealing with corporate governance might address issues such as appointment of directors, procedural rules for boards of directors, judicial review procedures in connection with removal of directors, and recognition of certain rights of the insolvency administrator, including the right to receive information.

14. In connection with such ad hoc arrangements, the Colloquium noted with interest the work conducted by Committee J of the Section on Business Law of IBA on a "Cross-Border Insolvency Concordat". The purpose of the Concordat, the fundamental approach of which is based on rules of private international law, is to suggest rules, some of which may be applicable in any cross-border insolvency, which the participants or courts could adopt for dealing with a variety of issues. Those issues include, for example, designation of the administrative forum, application of that forum's priority rules, certain rules for cases in which there is more than one administrative forum, and designation of applicable rules for avoidance of transfers of assets that took place in the period preceding the insolvency.

CONCLUSIONS

15. It may be noted that at the Colloquium there was a high degree of receptivity to the interest expressed by the Commission in a possible project on cross-border insolvency. Taking particular note of the views and observations concerning cross-border insolvency that were aired at the Colloquium by judges, practitioners, representatives of concerned organizations and Governments, the Secretariat will continue work relating to the assessment of the feasibility of work in this area requested by the Commission. In this endeavour, the Secretariat would cooperate with interested organizations and welcomes the offer of research assistance that has been extended by INSOL International.

16. Based on a current assessment of feasibility and drawing on the discussion at the Colloquium and the consultations with practitioners and interested organizations which it facilitated, it is possible at this stage to identify a number of sub-areas of the cross-border insolvency subject in which it would appear that some work by the Commission would not only be welcome, but feasible and useful. Moreover, it would appear possible to conduct work in those sub-areas without necessarily

straying into what is generally recognized as not, at least at this stage, a feasible, or necessarily even desirable, area of work, namely, the substantive unification of insolvency law.

17. One of those sub-areas of work that may seem at first to be modest, but that drew particular attention at the Colloquium and in which it would appear feasible to make a useful contribution in a relatively short time, concerns judicial cooperation. An opportunity for pursuing work in this area has already presented itself, as INSOL International is proposing to co-sponsor with UNCITRAL and organize, in conjunction with a regional conference it is to hold in Toronto in March 1995, a colloquium for judges on judicial cooperation in cross-border insolvency. The twin objectives of the judges' colloquium would be: firstly, to elicit the views of judges as to the extent to which judicial cooperation was possible under current law, for example, by application of the notion of comity, and exploring limits to cooperation under current law; secondly, to determine what rules might be necessary to enable judicial cooperation as a first step in dealing with difficulties that arise as a result of parallel proceedings and potentially conflicting legal regimes and jurisdictions.

18. A second sub-area, which it would appear useful to pursue and which in some respects may overlap with the first sub-area, may be broadly referred to under the rubric "access and recognition". This area may be understood to concern the granting of access to the courts to representatives of foreign insolvency proceedings or creditors, and to giving recognition to orders issued by foreign courts administering insolvency proceedings. Preliminary work in this area could identify the advantages and disadvantages of the different approaches found in the existing legislative systems providing for access and recognition, as well as in legislative-reform efforts at the national and multilateral level. It could also explore, from the standpoint of the needs of practice and the objectives of insolvency (e.g., equal treatment of creditors), the appropriateness of formulating uniform rules on access and recognition.

19. A third possibility that might in due time be considered for work by the Commission is the formulation of a set of model legislative provisions on insolvency. While it was not the conclusion of the Colloquium, and it is not here proposed to draft a comprehensive insolvency code with a view to achieving substantive unification of law, work in this area of law may eventually be important not only for Governments concerned with modernization of law, but also for the commercial community and for legal practitioners. It could be foreseen that much work might be conducted in a form that would avoid the difficulties that would be raised by attempting global unification of the substantive law of insolvency. In particular, such a project could be designed in a manner that would take into account the different policy options that a State would wish to consider in drafting its insolvency law, and would present model provisions for implementing those various policy options. The Commission may wish to note in connection with this type of possible work, and with a view to possible cooperation with Committee J of the Section on Business Law of IBA, the exploratory work being conducted by that body on fundamental concepts of a model insolvency code (see para. 11).

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POSSIBLE FUTURE WORK

Build-Operate-Transfer Projects

Note by the Secretariat

INTRODUCTION

1. At the Congress on International Trade Law held in May 1992 in New York in the context of the twenty-fifth session of the Commission, it was proposed that the Commission consider undertaking work in the field of the Build-Operate-Transfer (hereinafter referred to as "BOT") project financing concept. Consequent to that proposal, at its twenty-sixth session in 1993, the Commission had before it a note on possible future work (A/CN.9/378) in which the Secretariat informed the Commission that it was monitoring the work by the United Nations Industrial Development Organization (UNIDO) on the preparation of "Guidelines for the Development, Negotiating and Contracting of BOT Projects". The Commission emphasized the relevance of BOT and noted with appreciation the Secretariat's intention to present a note to the Commission on possible future work in the area. This note is intended to appraise the Commission of the current situation in this regard.

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THE BUILD-OPERATE-TRANSFER CONCEPT

2. In its most basic form, a BOT project is one in which a Government grants a concession for a period of time to a private consortium for the development of a project; the consortium then builds, operates and manages the project for a number of years after its completion and recoups its construction costs and makes a profit out of the proceeds coming from the operation and commercial exploitation of the project and, at the end of the concession period, the project is transferred to the Government.

3. In this arrangement, the repayments of any loans or returns on the investments made on the project is not guaranteed by the Government, but depends on the revenue generated by the project. Since direct funds from the public budget are not required, the Government of a country will thus experience reduced pressure of public borrowing, while allowing the transfer of the industrial risks and also of new technologies to the private sector. Furthermore, since the project is built and, during the concession period, operated by the consortium, the Government gains the benefit of private sector expertise in these areas.

4. Although BOT projects have largely been used in the development of large infrastructural projects such as telecommunications networks, highways and other public transportation projects, port facilities and in energy supply, increasingly it is also being utilized for medium and small scale projects. Thus, the potential exists for BOT to provide added opportunities for increased international trade.

5. BOT projects are attractive for a number of reasons. Amongst these are that they provide countries with decreasing borrowing capacity and declining budgetary resources an opportunity to finance projects without involving public funds. Also, they offer the benefits of stimulating investments and promoting privatization. Therefore, an increasing number of States, in particular developing countries, and lending agencies have become interested in offsetting such financial difficulties through BOT projects.

6. Among the main characteristics that differentiate BOT projects from other forms of project implementation are that the Government does not provide guarantees for the loans for the financing of the project, which necessitates non-traditional distribution of risks between a high number of contractually interrelated parties. Typically, the main parties in a BOT project would be: the project company (consortium), the Government, the lenders, the construction company, the insurers, the purchasers or users of the project's product. This multiplicity of parties and their interrelated contractual relationships give rise to complex and time consuming negotiations. Furthermore, the lack of expertise in putting together a BOT project, particularly within Governments, acts as a hinderance in the negotiating process.

7. The fact that the responsibility for repayment of any loans shifts from the traditional "client" (the Government) to the private consortium implies an increased risk to the lenders. Lenders are therefore placed in a situation where they have to look for additional means of reducing their risks, including insurance. This element of non-traditional distribution of risks between the various parties makes the pre-contractual stage of a BOT project usually fairly complex.

8. Another aspect that sometimes acts as a barrier in establishing BOT projects is the lack of legal certainty in some States regarding the realization of particular aspects of a project. For example, it might not be clear as to what extent private entities may draw revenue from the operations of public infrastructural projects such as operating toll roads. In light of such uncertainty, it would be difficult for the Government, for example, to issue a concession for the development of a highway BOT project since the consortium would, in most cases, only be able to ensure returns on its investments by collecting road tolls. In other instances, there might be lack of clarity as to the basis and effect of certain long term contractual assurances that the Government would need to make to the private consortium. Enabling legislation to make the underlying legal framework attractive for BOT projects may therefore need to be enacted.

THE UNIDO GUIDELINES

9. The above mentioned problems, amongst others, and the potential for the development of BOT projects, led UNIDO to initiate the preparation of "Guidelines for the Development, Negotiation and Contracting of BOT Projects". In addition to disseminating information on BOT projects, the objective of the Guidelines is to enable States and all other interested parties to devise and formulate the appropriate approach in promotion and development of BOT projects.

10. The UNIDO Guidelines will be divided into chapters entitled as follows:

Introduction to the BOT concept; Phases of a BOT project; Macro economic considerations; Role of Government; Financial analysis (feasibility study) and economic analysis; Risk allocation and management (financial structuring); Procurement issues; Transfer of technology and capacity building; Building and construction; Operation and maintenance; Transfer of ownership; Contract package and coordinating the contracts (roadmap to the required contracts); Project agreement; Conclusion (possibly including a summary of success cases).

11. The Secretariat has been monitoring the progress within UNIDO on the Guidelines. The preparation is at an advanced stage and it is expected that the Guidelines will be finalized in September 1994.

CONCLUSION

12. Although legal aspects of BOT will form part of the UNIDO Guidelines, by reason of the large scope of the Guidelines, it will not be possible to deal with some of these aspects in a detailed manner. It is the intention of the Secretariat, once the UNIDO Guidelines are finalized, to study the desirability and feasibility of further work by the Commission on some of the problems raised with regard to BOT projects. This may include, for example, the creation of an enabling legal framework for BOT projects, in particular for the concession agreement, or guidance to the parties on contracting issues, for example, by supplementing the UNCITRAL Legal Guide on Contracts for the Construction of Industrial Works.